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No. 05-1398

In the Supreme Court of the United States

NEXBANK SSB, ET AL.,
Petitioners,

v.

AMERICAN HOMEPATIENT, INC., ET AL.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

PETITIONERS' REPLY BRIEF

JAMES R. KELLEY
Counsel of Record
Neal & Harwell, PLC
One Nashville Place
Suite 2000
150 4th Avenue North
Nashville, TN 37219
(615) 244-1713

LENARD M. PARKINS
ROBIN E. PHELAN
ALAN WRIGHT
Haynes and Boone, LLP
901 Main Street
Suite 3100
Dallas, TX 75202
(214) 651-5000

Counsel for Petitioners
Nexbank, SSB, et al.

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THE COURT OF APPEALS' DECISION CONFLICTS WITH *TILL*'S INSTRUCTION THAT THE DETERMINATION OF THE APPROPRIATE DISCOUNT RATE REQUIRES CONSIDERATION OF CHARACTERISTICS SPECIFIC TO THE DEBTOR AND TO THE LOAN.

The Court's plurality opinion in *Till v. SCS Credit Corporation* adopted the formula approach for determining the appropriate discount rate for cramdown loans in the Chapter 13 context. 541 U.S. 465, 478-80 (plurality op.). Under the formula approach, a bankruptcy court begins with a risk-free interest rate and adjusts it upward in consideration of "such factors as the circumstances of the estate, the nature of the security, and the duration and feasibility of the reorganization." *Id.* at 479 (plurality op.) The purpose of this adjustment is "to ensure that an objective economic analysis would suggest the debtor's interest payments will adequately compensate all such creditors for the time value of money and the risk of default." *Id.* at 477 (plurality op.).

Since debtors, reorganization plans, and loan terms differ in every bankruptcy case, it is impossible to prescribe a discount rate or even a range of discount rates that will adequately compensate creditors without regard for the particular facts of the case. As the Court recognized in *Till*, circumstances might require a discount rate that is "eye-popping." 541 U.S. at 480-81 (plurality op.). However, the Court's response to this situation was not to instruct the bankruptcy court to reduce the discount rate but to conclude that "the plan probably should not be confirmed." *Id.*

The importance of an objective evidentiary analysis to determine whether the secured creditor receives adequate compensation in a cramdown is not lessened in a Chapter 11

reorganization case, which is very different from a Chapter 13 case. As the Court recognized in *Till*, Congress likely "intended bankruptcy judges and trustees to follow essentially the same approach when choosing an appropriate interest rate under" the present value provisions in Chapters 11, 12, and 13. *Id.* at 474 (plurality op.).

In addition, the applicable statute, 11 U.S.C. § 1129(b)(2)(A)(i)(II), states plainly that the value of the "deferred cash payments" a secured creditor receives in a cramdown must have a value as of the plan's effective date "of at least the value of such holder's interest in the estate's interest in such property." 11 U.S.C. § 1129(b)(2)(A)(i)(II); *see Till*, 541 U.S. at 469 (plurality op.) (where the debtor's plan provides for installment payments, "the amount of each installment must be calibrated to ensure that, over time, the creditor receives disbursements whose total present value [as of the effective date of the plan] equals or exceeds that of the allowed claim."). To satisfy the requirements of *Till*, the total present value must be determined by debtor-specific evidence, and not by reliance on generic industry averages. That was not done in this case.

In disregard of the Court's clear instruction and economically sound reasoning in *Till*, the court of appeals' opinion and Debtors' Brief in Opposition adopt an approach that ignores economic realities. The bankruptcy court in this case followed the "coerced loan theory," which, under Sixth Circuit precedent, directed bankruptcy courts to "the use of 'more generally applicable rates' and not loan-specific rates." Pet. App. 117a (citation omitted). Accordingly, the bankruptcy court accepted the discount rate proposed by Debtors' expert, even though his analysis failed to consider Debtors' specific circumstances (*e.g.*, leverage and business risks) or the specific characteristics of the cramdown loan

(*e.g.*, debt-to-value ratio). Pet. App. 111a, 120a. The expert instead merely determined an interest rate for generic non-amortizing, non-investment grade senior debt in the healthcare industry. Pet. App. 111a.

Despite the bankruptcy court's explicit determination not to consider "loan-specific rates" and its adoption of a discount rate that failed to consider characteristics specific to Debtors or to the cramdown loan, the court of appeals remarkably concluded that "[o]ur understanding of the bankruptcy court's methodology, however, is that it in fact sought to determine what an efficient market would have produced for the loan that the lenders provided, albeit under the rubric of the coerced loan theory." Pet. App. 18a; *see also* Br. Opp'n 8-9. In affirming the bankruptcy court's decision on this ground, the court of appeals approved an approach to determining the discount rates on cramdown loans that conflicts with the Court's guidance in *Till*.

In seeking to justify its conclusion, the court of appeals misinterpreted two parts of the *Till* decision, misinterpretations that Debtors employ with a vengeance. First, although the plurality opinion in *Till* noted that "[w]e do not decide the proper scale for the risk adjustment, as the issue is not before us," it went on to observe that "other courts have generally approved adjustments of 1% to 3%." 541 U.S. at 480 (plurality op.). The court of appeals interpreted this plainly descriptive statement as normative: "The opinion . . . cited with approval the fact that other courts starting from the prime rate 'have generally approved adjustments of 1 % to 3 %.'" Pet. 19a (citation omitted). For Debtors, this 1-3% observation becomes evidence that the discount rate sought by Petitioners is conclusively excessive. Br. Opp'n 2, 3, 6, 15, 16. It defies sound economic reasoning for the court of appeals and Debtors to use the 1-

3% range in this manner. The risk of default that a creditor faces can only be determined by examining the facts on the ground, *i.e.*, the specific characteristics of the debtor and of the loan. The range of possible risk adjustments cannot be stated as an absolute and unwavering legal rule without regard for the risks presented by the individual debtor as shown by the evidence in each case.

Examination of the circumstances of the estate, the nature of the security, and the duration and feasability of the reorganization might require a high cramdown discount rate in a particular case. For instance, a proper cramdown analysis under *Till* would produce a high discount rate for a secured creditor of a domestic automobile manufacturer in bankruptcy, where the plan of reorganization calls for a 20-year payout to the secured creditor and the creditor's claim is secured by old or obsolete factories and facilities that have no value above the creditor's loan amount. As this example shows, an appropriate discount rate cannot be determined consistent with *Till* unless the market-based risk characteristics of the specific debtor, as shown by the evidence at the confirmation hearing, are considered.

Second, both the court of appeals and Debtors misinterpret the Court's reference to an "'eye-popping' interest rate." *Till*, 541 U.S. at 480-81 (plurality op.) (citation omitted). The Court anticipated that a bankruptcy court, after analyzing the relevant factors in the specific case, might determine that a rate required "to compensate the creditor for its risk" could be "so high as to doom the plan." *Id.* at 480 (plurality op.). (The fact that the Court anticipated such a situation shows that the 1-3% observation was not intended to be normative.) The Court concluded that the proper response in such a situation is to not confirm the reorganization plan. *Id.* at 480-81 (plurality opinion). The

court of appeals misused this clear statement as evidence against the discount rate sought by Debtors: "The interest rate demanded by the lender here . . . . As such, the 12.16% rate appears to fall under the "eye-popping" category described unfavorably by *Till*." Pet. App. 19a; *see also* Br. Opp'n 7, 10. However, *Till* made no judgment about the propriety of high interest rates. Instead, *Till* rightly recognized that the proper interest rate depends on the facts on the ground, and that other things might need to be altered in consideration of the required interest rate in a particular case.

CONCLUSION

The Sixth Circuit is bound by this Court's *Till* decision. The Court should grant the petition.

Respectfully submitted,

JAMES R. KELLEY
Counsel of Record
NEAL & HARWELL, PLC
One Nashville Place
Suite 2000
150 4th Avenue North
Nashville, TN 37219
(615) 244-1713

LENARD M. PARKINS
ROBIN E. PHELAN
ALAN WRIGHT
HAYNES AND BOONE, LLP
901 Main Street
Suite 3100
Dallas, TX 75202
(214) 651-5000

Counsel for Petitioners